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FISCAL IMPACT STATEMENT

LS 7586

BILL NUMBER: HB 1625

NOTE PREPARED: Jan 19, 2005

BILL AMENDED:

SUBJECT: Tax exemption for Military Pension Benefits.

FIRST AUTHOR: Rep. Woodruff

FIRST SPONSOR:

BILL STATUS: As Introduced

FUNDS AFFECTED: X GENERAL
X DEDICATED
FEDERAL

IMPACT: State & Local

Summary of Legislation: The bill provides a deduction in computing Adjusted Gross Income to a veteran who has served in the United States Armed Forces during a time of war for all income attributable to a military pension.

Effective Date: January 1, 2006.

Explanation of State Expenditures: The Department of State Revenue (DOR) would incur some administrative expenses relating to the revision of tax forms, instructions, and computer programs to incorporate this deduction. The DOR's current level of resources should be sufficient to implement these changes.

Explanation of State Revenues: *Summary:* The bill would reduce Adjusted Gross Income (AGI) Tax liabilities of individual taxpayers who receive military retirement and who served in the U. S. Armed Forces during a time of war specified under the bill. Assuming that 50% to 75% of the military retirees residing in Indiana served in the Armed Forces during a time of war specified by the bill, the revenue loss could potentially total about \$6.2 M to \$9.3 M in FY 2007. Thereafter, the revenue loss could potentially increase by about 0.94% annually.

Background: The bill provides that all military retirement pay received by an eligible veteran during the taxable year may be deducted from AGI. This deduction would be in lieu of the existing \$2,000 deduction for military retirement pay. The bill defines an "eligible veteran" as an individual who served in the U. S. Armed Forces during one of the wartime periods listed below:

- (1) World War I - April 6, 1917, to November 11, 1918.
- (2) World War II - December 7, 1941, to December 31, 1946.
- (3) Korean Conflict - June 27, 1950, to January 31, 1955.
- (4) Vietnam era - August 5, 1964, to May 7, 1975.
- (5) Persian Gulf War - August 2, 1990, to a date to be set by presidential proclamation or federal law.
- (6) Afghanistan War - September 11, 2001, to a date to be set by presidential proclamation or federal law.
- (7) Iraq War - March 19, 2003, to a date to be set by presidential proclamation or federal law.

The fiscal impact is based on state income tax return data and census and pay rate data for military retirees in Indiana reported by the Department of Defense (DOD). State tax data indicates that 36,513 taxpayers claimed the deduction for military service pay and retirement benefits in tax year 2002, deducting approximately \$72.2 M in military pay and retirement benefits. The DOD census and pay rate data suggests that about \$44.7 M of this total is attributable to military retirement. This amount resulted in a revenue loss of about \$1.5 M. This data also suggests that the retirement portion of the deduction is increasing slightly by 0.94% annually. It is estimated that military retirement income in excess of that deductible under current law could potentially total about \$363.0 M in 2006.

The most recent national survey of veterans conducted by the U. S. Department of Veterans Affairs provides an estimate of the distribution of veterans by period of service. The distribution is reported in the table below. It is important to note that veterans responding to the survey could indicate service in more than one period. Thus, the percentages do not sum to 100.

Service Period	Percentage of Respondents
World War II	20.5%
Between World War II and the Korean Conflict	6.7%
Korean Conflict	16.9%
Between the Korean Conflict and the Vietnam Era	25.6%
Vietnam Era	36.1%
Post-Vietnam Era	27.9%
Gulf War	13.9%

Based on this distribution it is assumed that 50% to 75% of the retirement benefits that are currently not deductible could potentially be paid to eligible veterans. Thus, the additional deductible amount would range from \$181.5 M to \$272.3 M, with a revenue loss ranging from \$6.2 M to \$9.3 M in the first year. The revenue loss could be somewhat lower to the extent that retirement income is already tax exempt (i.e., disability retirement income). Recent DOD retirement pay data does not delineate between taxable and tax exempt military retirement payments to Indiana retirees. However, the proportion that is tax exempt is not expected to exceed 10% of total retirement payments.

Since the bill is effective beginning in tax year 2006, the revenue loss would begin in FY 2007. Eighty-six percent of the revenue from the AGI Tax on individuals is deposited in the state General Fund, and 14% of this revenue is deposited in the Property Tax Replacement Fund.

Explanation of Local Expenditures:

Explanation of Local Revenues: Because the proposed exemption for military retirement benefits would serve to decrease taxable income, counties imposing local option income taxes (CAGIT, COIT, and/or CEDIT) may, as a result, experience an indeterminable decrease in revenue from these taxes.

State Agencies Affected: Department of State Revenue.

Local Agencies Affected: Counties with a local option income tax.

Information Sources: OFMA Income Tax databases, 1998-2002. Deborah Williamson, Department of Defense, Manpower Data Center, (831) 583-2400. Department of Veterans Affairs, *2001 National Survey of Veterans*.

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